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No. 14-840

# In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

*v.*

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE DISTRICT OF COLUMBIA CIRCUIT*

## BRIEF FOR THE PETITIONER

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## QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission reasonably concluded that it has authority under the Federal Power Act, 16 U.S.C. 791a *et seq.*, to regulate the rules used by operators of wholesale electricity markets to pay for reductions in electricity consumption and to recoup those payments through adjustments to wholesale rates.

2. Whether the court of appeals erred in holding that the rule issued by the Federal Energy Regulatory Commission is arbitrary and capricious.

## PARTIES TO THE PROCEEDING

Petitioner, the Federal Energy Regulatory Commission, was the respondent in the court of appeals.

EnerNoc, Inc., EnergyConnect, Inc., Coalition of MISO Transmission Customers, PJM Industrial Customer Coalition, and Viridity Energy, Inc., are petitioners in No. 14-841, which arises from the same proceeding below and presents the same questions as this case, and they were intervenors in support of the respondent in the court of appeals.

Respondents American Public Power Association, California Independent System Operator Corporation, Edison Electric Institute, Electric Power Supply Association, National Rural Electric Cooperative Association, Old Dominion Electric Cooperative, and the California Public Utilities Commission were the petitioners in the court of appeals.

Respondents American Municipal Power, Inc., Lower Mount Bethel Energy, LLC, Madison Gas and Electric Company, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, PJM Power Providers Group, PPL Brunner Island, LLC, PPL Electric Utilities Corporation, PPL EnergyPlus, LLC, PPL Holtwood, LLC, PPL Maine, LLC, PPL Martins Creek, LLC, PPL Montour, LLC, PPL Susquehanna, LLC, PSEG Energy Resources & Trade LLC, PSEG Power LLC, Public Service Electric and Gas Company, Southern Minnesota Municipal Power Agency, and WPPI Energy were intervenors in support of the petitioners in the court of appeals.

Respondents American Forest & Paper Association, Maryland Public Service Commission, Pennsylvania Public Utility Commission, PJM Interconnection, L.L.C., Steel Producers, and Wal-Mart Stores, Inc. were intervenors in support of the respondent in the court of appeals.

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## BRIEF FOR THE PETITIONER

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-48a) is reported at 753 F.3d 216. FERC Order No. 745 (Pet. App. 49a-172a) is reported at 134 FERC ¶ 61,187. FERC Order No. 745-A (Pet. App. 173a-275a) is reported at 137 FERC ¶ 61,215. FERC Order No. 745-B (Pet. App. 276a-281a) is reported at 138 FERC ¶ 61,148.

### JURISDICTION

The judgment of the court of appeals was entered on May 23, 2014. Petitions for rehearing were denied on September 17, 2014 (Pet. App. 282a-285a). On December 8, 2014, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including January 15, 2015, and the petition was

filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

The pertinent statutory and regulatory provisions are reproduced in the appendix to this brief. See App., *infra*, at 1a-16a.

## STATEMENT

As a consequence of technological, legislative, and regulatory changes over the last two decades, much of the Nation's wholesale-electricity market is now run by regional nonprofit entities regulated by the Federal Energy Regulatory Commission (FERC or Commission). Like commodities exchanges, these wholesale-market operators set the rates for wholesale sales of electricity by matching supply and demand in real-time and day-ahead markets. They have typically achieved that balance by increasing the amount of generated power supplied to the grid as electricity demand increases. But wholesale-market operators have also balanced supply and demand by paying certain electricity users to commit to reduce their consumption from the grid at particular times, an activity that Congress and the Commission have termed "demand response." Those payments are then recouped by adjusting wholesale rates.

In the orders under review here, FERC established a methodology that wholesale-market operators that employ demand-response commitments must use to compute the compensation paid for those commitments. Pet. App. 49a-275a; see 18 C.F.R. 35.28(g)(1)(v). In essence, that formula requires that, in certain circumstances, a commitment to reduce demand be compensated the same amount as an

equivalent commitment by generators to increase supply. The court of appeals vacated the orders, holding (i) that FERC lacked the statutory authority to establish that methodology because, in the court's view, demand response is solely a retail phenomenon; and (ii) that the Commission had failed to sufficiently respond to objections to the particular compensation formula that the orders adopt. Pet. App. 1a-17a.

**A. Regulatory And Technical Background**

1. The electric power system consists of three components: the generation of electricity at power plants and other facilities; the transmission of electricity over long distances on high-voltage lines; and the distribution of electricity to users by "load-serving entities" on low-voltage lines. See Office of Enforcement, FERC, *Energy Primer: A Handbook of Energy Market Basics* 50 (July 2012) (*Energy Primer*).[1] Originally "most electricity was sold by vertically integrated utilities that had constructed their own power plants, transmission lines, and local delivery systems," *New York* v. *FERC*, 535 U.S. 1, 5 (2002), and its sale was regulated only by state agencies. This Court held in 1927, however, that the Commerce Clause bars the States from regulating certain interstate electricity transactions, such as a wholesale sale of power (*i.e.*, a sale for resale) across state lines. See *id.* at 6 (citing *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83, 89 (1927)).

Congress responded to the *Attleboro* decision by enacting the Federal Power Act (FPA), ch. 687, Tit. II, 49 Stat. 847 (16 U.S.C. 791a *et seq.*). The FPA

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[1] http://www.ferc.gov/market-oversight/guide/energy-primer.pdf.

authorized the Federal Power Commission, FERC's predecessor, to regulate certain components of the electric-power system. 16 U.S.C. 792; see 42 U.S.C. 7151(b), 7172(a)(1). Section 824(b) of the FPA gives FERC jurisdiction over (i) "the sale of electric energy at wholesale in interstate commerce," and (ii) "the transmission of electric energy in interstate commerce." 16 U.S.C. 824(b)(1).

Sections 824d and 824e in turn set forth FERC's core regulatory duties. First, the Act provides that "[a]ll rates and charges" by any public utility "for or in connection with" interstate transmissions or wholesale sales, and "all rules and regulations affecting or pertaining to such rates or charges," shall be "just and reasonable." 16 U.S.C. 824d(a) and (b), 824e(a). Second, if FERC finds that "any rate, charge, or classification," or "any rule, regulation, practice, or contract affecting such rate, charge, or classification," is "unjust, unreasonable, unduly discriminatory or preferential," FERC shall determine and prescribe what is just and reasonable. 16 U.S.C. 824e(a).

The FPA also establishes specific limits on FERC's authority that preserve a sphere of exclusive state jurisdiction. With respect to sales, Section 824(b) provides that, apart from the sales specifically identified in the FPA, the statute "shall not apply to any other sale of electric energy." 16 U.S.C. 824(b)(1). For that reason, FERC lacks jurisdiction to regulate retail sales (*i.e.*, sales to users of electricity), which have long been regulated by state utility commissions. *New York*, 535 U.S. at 17, 23.

2. Since the 1970s, a combination of technological advances and policy reforms has given rise to market competition in the Nation's electricity system. Inde-

pendent power generators—that is, generators that do not own transmission lines or distribution facilities—have proliferated. See *Transmission Access Policy Study Grp.* v. *FERC*, 225 F.3d 667, 681 (D.C. Cir. 2000) (per curiam), aff'd *sub nom. New York*, *supra*. And "unlike the local power networks of the past," the electricity grid is now national in scope, such that "any electricity that enters the grid immediately becomes a part of a vast pool of energy that is constantly moving in interstate commerce." *New York*, 535 U.S. at 7. As a consequence, "it is now possible for power companies to transmit electric energy over long distances at a low cost." *Id.* at 7-8. But major utilities by and large still own the high-voltage transmission lines. That ownership could permit them "either to refuse to deliver energy produced by competitors or to deliver competitors' power on terms and conditions less favorable than those they apply to their own transmissions." *Id.* at 8-9.

To address that threat to competition, Congress amended the FPA in Title VII of the Energy Policy Act of 1992, Pub. L. No. 102-486, §§ 721-726, 106 Stat. 2915-2921. Those amendments authorize FERC to order utilities that own transmission lines to transmit power sold by competitors. See 16 U.S.C. 824j-824k. In 1996, after issuing a series of utility-specific orders, FERC invoked its powers under Sections 824d and 824e to promulgate a general rule addressing the problem. That rule requires transmission-owning utilities to file tariffs offering nondiscriminatory "open access" transmission services to wholesale power suppliers on standard terms. See *New York*, 535 U.S. at 9-14.

In the past two decades, FERC has continued to "break down regulatory and economic barriers that hinder a free market in wholesale electricity" and to "promote competition in those areas of the industry amenable to competition." *Morgan Stanley Capital Grp. Inc.* v. *Public Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527, 536 (2008). In particular, "[t]o further pry open the wholesale-electricity market and to reduce technical inefficiencies caused when different utilities operate different portions of the grid independently," FERC issued a rule encouraging transmission-owning utilities to relinquish control of their transmission lines to nonprofit entities (called "Regional Transmission Organizations" and "Independent System Operators" (ISOs)) charged with operating "organized" wholesale markets in a nondiscriminatory manner. *Id.* at 536-537; see *Energy Primer* 41-42. The Nation's seven wholesale-market operators—New England ISO, New York ISO, PJM Interconnection, Midcontinent-ISO, Southwest Power Pool, California ISO, and the Electric Reliability Council of Texas—together now serve two-thirds of the national electricity load. *Id.* at 42-43.[2] They have the responsibilities of "[e]nsur[ing] the reliability of the transmission grid," "balanc[ing] supply and demand instantaneously," and "plan[ning] for transmission expansion on a regional basis." *Id.* at 63.

3. These wholesale-market operators run real-time and day-ahead auction markets that set the rates for wholesale electricity in their respective regions. See *Energy Primer* 64. Using sophisticated computerized systems, the operators match up generators' bids to

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[2] The Electricity Reliability Council of Texas is generally not subject to FERC's jurisdiction under Sections 824d and 824e.

supply electricity at specified prices with electricity demand from load-serving entities, which then deliver power to consumers in the state-regulated retail market. *Ibid.*; see, *e.g.*, *PJM Markets Fact Sheet* (June 18, 2014).[3] Each accepted bid is paid the "locational marginal price," or LMP, which represents the least-cost price of meeting a marginal increase in demand at each of the many geographic nodes within a region, and so reflects the value of electricity at particular locations and times. *Energy Primer* 65-66; see Pet. App. 3a.

Although some variation exists among wholesale-market operators, LMP generally consists of the sum of three components: (i) the cost of generation; (ii) the cost of congestion; and (iii) the cost of transmission losses. *Black Oak Energy, LLC* v. *FERC*, 725 F.3d 230, 234 (D.C. Cir. 2013); *Energy Primer* 65. Roughly speaking, the cost of generation is derived from bids submitted in the auction markets by generators to supply power to the system. The highest-cost bid that the system must accept to balance supply and demand equals the generation-cost component of LMP. See, *e.g.*, PJM Open Access Transmission Tariff (PJM Tariff), Att. K App. § 2.5(a).[4] For example, if three generators offer to supply a quantity of power for $20, $40, and $70 per megawatt-hour, respectively, and the system accepts only the first two bids to balance supply and demand, the generation cost component

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[3] http://www.pjm.com/~/media/about-pjm/newsroom/fact-sheets/pjms-markets-fact-sheet.ashx (last visited July 8, 2015).

[4] http://www.pjm.com/~/media/documents/agreements/tariff.ashx (last visited July 8, 2015).

equals $40. See generally PJM, *LMP Overview*, slides 12-13;[5] see also J.A. 485-486 & n.18.

The congestion component of LMP accounts for the fact that grid congestion may require the system to take power from more costly generators in less congested areas. *Wisconsin Pub. Power, Inc.* v. *FERC*, 493 F.3d 239, 250-251 (D.C. Cir. 2007) (per curiam); *Energy Primer* 65-66. The transmission-losses component accounts for the natural dissipation of electricity that occurs when power supply is transmitted over long distances. *Black Oak Energy*, 725 F.3d at 234.

Once LMP is calculated for a particular node and time, every accepted supplier is paid LMP (even if an efficient generator's bid was far lower than LMP). The general principle is that LMP represents the marginal cost of satisfying demand for that node at that time. Because in an ordinary market the intersection of the marginal-cost curve and the marginal-benefit curve equals the price of a good, LMP attempts to replicate the price that an ordinary market would produce. See Steven Stoft, *Power System Economics: Designing Markets for Electricity* 220 (2002).

**B. Demand Response In Wholesale Markets**

1. The traditional way that wholesale-market operators meet increased demand for electricity is by adding more electricity supply to the system. But particularly at peak periods, such as hot summer days, incremental increases in generation can be very expensive, causing LMP to substantially increase. Since electricity generally cannot be stored, during such periods the system must take power from the most

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[5] https://pjm.adobeconnect.com/_a16103949/p3c7rb6whya/ (last visited July 8, 2015).

inefficient power plants. Pet. App. 23a (Edwards, J., dissenting). That results in higher wholesale rates.

The other way to balance supply and demand is to decrease demand. In many industries, demand naturally decreases as price increases. But electricity demand has historically been relatively inelastic. See *Energy Primer* 43. That is both because electricity is a necessity that has few ready substitutes and because state regulatory authorities often do not permit retail rates to fluctuate with increases in wholesale rates. See *id.* at 2, 9, 43-44.

Demand can be reduced, however, by paying electricity consumers for commitments to curtail their consumption of power from the electricity system during peak periods. If those payments are less than the cost of adding more power, they will enable the wholesale-market operator to balance supply and demand with a smaller increase in wholesale rates. This practice of paying entities to refrain from taking power from the electricity system is one type of what Congress and FERC have termed "demand response." See *Energy Primer* 46-47; see also 16 U.S.C. 2642 note. Besides reducing rates, demand response, by decreasing the amount of power necessary to balance supply and demand, reduces the risk of system failures like blackouts and curbs the market power of generators. Pet. App. 60a-61a & n.19.

Demand-response programs exist in both retail and wholesale markets. See *Energy Primer* 47-48. At the retail level, States are implementing programs like "critical-peak rebates," in which retail customers are given rebates on their bills for curtailing electricity use, and "dynamic pricing," in which rates fluctuate to reflect cost. *Id.* at 48.

At the wholesale level, third-party aggregators of electricity users, as well as local utilities and large individual users like factories, bid demand-response commitments into the wholesale auction markets, "specifying the hours, number of megawatts and price at which they are willing to curtail." *Energy Primer* 48. The wholesale-market operators then treat those commitments like bids from generators, accepting the lowest bids that will balance the system. The payments for the accepted demand-response bids are recouped from wholesale purchasers in the wholesale rates they pay. Since the early 2000s, wholesale-market operators have obtained FERC approval of changes in their tariffs permitting them to implement and expand demand-response programs. See, *e.g.*, *PJM Interconnection, L.L.C.*, Order Accepting Tariff Sheets as Modified, 95 F.E.R.C. ¶ 61,306 (2001); *New York Indep. Sys. Oper., Inc.*, Order on Tariff Filing, 95 F.E.R.C. ¶ 61,223 (2001).

2. In the Energy Policy Act of 2005 (EPAct), Pub. L. No. 109-58, 119 Stat. 594, Congress established as "the policy of the United States that * * * unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated." § 1252(f), 119 Stat. 966 (16 U.S.C. 2642 note). The "energy" market is the market in electricity at issue here. The "capacity" market involves longer-term commitments designed to spur investment in infrastructure, and "ancillary services" provide electricity to help the grid run efficiently, and in emergencies, such as through operating reserves. In 2007, Congress further instructed FERC to develop a national action plan for demand response. See Energy Independence and Security Act of 2007, Pub.

L. No. 110-140, § 529(a), 121 Stat. 1664-1665 (42 U.S.C. 8279).

In light of these congressional enactments, FERC has issued rules addressing the participation of demand-response providers in the markets under its regulatory authority. In 2007, FERC permitted the use of demand-response commitments in organized wholesale markets for certain ancillary services on a comparable basis with generation resources. See 72 Fed. Reg. 12,266, at 12,378-12,379 ¶¶ 887-888 (Mar. 15, 2007) (Order No. 890); see also Pet. App. 62a.

The following year, FERC promulgated Order No. 719, which requires all wholesale-market operators to accept bids from demand-response providers in markets for certain ancillary services on a basis comparable to other resources, unless such participation is prohibited by the relevant state regulatory authority. See 73 Fed. Reg. at 64,100, 64,107 ¶¶ 47-49 (Oct. 28, 2008) (Order No. 719); see also 18 C.F.R. 35.28(g)(1)(i)(A). Order No. 719 also requires wholesale-market operators to permit aggregators of retail customers to bid demand-response commitments directly into wholesale markets (again, unless prohibited by state authorities). See 18 C.F.R. 35.28(g)(1)(iii). In addition, FERC ordered wholesale-market operators to study whether further measures were necessary to eliminate barriers to the participation of demand-response providers in wholesale markets. 73 Fed. Reg. at 64,101-64,102. No party sought judicial review of Order No. 719.

**C. Orders Under Review**

1. Wholesale-market operators have varied in the level of compensation they pay for demand-response commitments. See Pet. App. 63a-65a. In 2010, after

reviewing the reports that it had solicited in Order No. 719, FERC issued a Notice of Proposed Rulemaking (NPRM) proposing to adopt a uniform compensation formula, set at LMP, for demand-response commitments in wholesale-energy markets. J.A. 19-59. Following an initial round of comments, FERC issued a supplemental NPRM seeking further comments on certain issues, and it held a technical conference. Pet. App. 66a-67a.

2. FERC then issued Order No. 745, entitled *Demand Response Compensation in Organized Wholesale Energy Markets*. See Pet. App. 49a-172a. We refer to the order as the "Rule"; it is codified at 18 C.F.R. 35.28(g)(1)(v). Pet. App. 148a-149a. The Rule imposes requirements on wholesale-market operators designed to eliminate barriers to the use of demand-response commitments in their energy markets.

The Rule's most significant requirement is that wholesale-market operators must use the LMP formula to compensate demand-response providers. See Pet. App. 89a-104a. FERC chose LMP after "find-[ing], based on the record here[,] that, when a demand response resource has the capability to balance supply and demand as an alternative to a generation resource, and when dispatching and paying LMP to that demand response resource is shown to be cost-effective," it would be "unjust and unreasonable" for a wholesale-market operator to pay "compensation other than the LMP." *Id.* at 90a-91a.

FERC provided that two conditions must be met before payment of LMP is required. First, the demand-response commitment must help the operator balance supply and demand in the wholesale market by displacing additional power supply. Pet. App. 91a.

Second, "the payment of LMP for the provision of the service by the demand response resource must be cost-effective" under what the Commission termed the "net benefits test." *Id.* at 92a. That condition ensures that a wholesale-market operator will be required to pay LMP to a demand-response provider instead of adding more supply only when doing so "results in a reduction in the total amount consumers pay for resources that is greater than the money spent acquiring those demand response resources at LMP." *Id.* at 93a; see p. 50, *infra* (discussing net-benefits test).

The Commission rejected the view that the optimal compensation methodology would be LMP reduced by some portion of the retail payments that the demand-response provider would have made had it purchased power (a methodology called "LMP-G"). See Pet. App. 100a-101a. FERC explained that it ordinarily does not "inquire into the costs or benefits of production for the individual resources participating as supply resources in the organized wholesale electricity markets," and that it saw no reason "why it would be appropriate for the Commission to continue to apply this approach to generation resources yet depart from this approach for demand response resources." *Id.* at 101a-102a. FERC concluded that paying demand-response providers the full value of their contribution to the market would help overcome preexisting barriers to demand-response participation and increase the reliability and competitiveness of wholesale markets. *Id.* at 59a-61a, 97a-99a.

The Rule also establishes how demand-response payments must be recouped from wholesale-electricity purchasers. It requires the cost of the payments to be allocated proportionally to all wholesale-market pur-

chasers that benefit from the resulting reduction of the price of wholesale electricity in a particular location on the grid. Pet. App. 128a-129a. In addition, the Rule instructs wholesale-market operators to review their existing protocols for ensuring that demand-response providers are in fact reducing expected power consumption. *Id.* at 123a-125a.

Finally, FERC "reject[ed] challenges to the Commission's authority to set the compensation level for demand response in organized wholesale energy markets." Pet. App. 137a. The Commission pointed to its conclusion in previous rulemakings that "demand response directly affects wholesale rates" when it "is bid directly into the wholesale market." Order No. 719-A, 74 Fed. Reg. 37,776, 37,783 ¶¶ 46-47 (July 29, 2009); see Pet. App. 137a & nn.216-217. Because of that direct effect, the Commission concluded that it "has jurisdiction to regulate the market rules under which [a wholesale-market operator] accepts a demand response bid into a wholesale market." *Id.* at 137a.

3. FERC denied requests for rehearing. See Pet. App. 173a-281a. It again rejected challenges to its statutory authority, explaining that "demand response participation in the organized wholesale energy markets and the market rules governing that participation are 'practices affecting rates' pursuant to sections [824d and 824e] of the FPA." *Id.* at 188a-200a. Specifically, FERC explained that "in the circumstances covered by the Final Rule, demand response resources are direct participants in the organized wholesale energy markets over which [FERC has] jurisdiction," and "that participation has a direct and substantial effect on rates in those markets." *Id.* at

198a. Because the Rule's scope is limited in that manner, FERC rejected the argument of some commenters that its interpretation of its statutory authority would encompass "input cost[s] for generation," such as the price of "cement, steel, or coal," that only "indirectly affect[] wholesale rates." *Id.* at 197a-198a.

FERC also further discussed why the LMP-G alternative formula was unwarranted and would likely result in insufficient demand-response participation in wholesale markets. See Pet. App. 210a-223a.

4. Commissioner Moeller dissented from the initial order and the order on rehearing. See Pet. App. 156a-172a, 269a-275a. He did not question the Commission's conclusion that it had authority to promulgate the Rule, and he emphasized that "demand response plays a very important role in [wholesale] markets by providing significant economic, reliability, and other market-related benefits." *Id.* at 156a; see *id.* at 269a. But he would have "allow[ed] the regional [wholesale] markets to continue to develop their own compensation proposals," or, in the alternative, adopted the LMP-G formula. *Id.* at 172a; see *id.* at 269a-270a.

**D. Decision Of The Court Of Appeals**

1. Organizations representing electricity generators and others sought judicial review of the Rule in the Court of Appeals for the District of Columbia Circuit. A divided panel of that court vacated the Rule in its entirety as "*ultra vires* agency action." Pet. App. 1a-17a.

a. The court of appeals acknowledged that it was required to "address FERC's assertion of its statutory authority under the familiar *Chevron* doctrine," by asking "'whether the statutory text forecloses the agency's assertion of authority.'" Pet. App. 5a (quot-

ing *City of Arlington* v. *FCC*, 133 S. Ct. 1863, 1871 (2013)). The court then concluded that the text of the FPA does "unambiguously" foreclose FERC from ensuring that the level of compensation paid by wholesale-market operators for demand-response commitments in their markets is just and reasonable. See *id.* at 5a-14a.

The court of appeals rejected FERC's argument that the Rule is authorized by Sections 824d and 824e, which require the Commission to ensure that "any rule, regulation, practice, or contract *affecting* [a wholesale] rate," is just and reasonable. 16 U.S.C. 824e(a) (emphasis added). See Pet. App. 7a. The court "agree[d] with the Commission that demand response compensation affects the wholesale market." *Id.* at 7a. But the court believed that the Commission's assertion of authority on that basis "has no limiting principle" and "could ostensibly authorize FERC to regulate any number of areas, including the steel, fuel, and labor markets." *Id.* at 8a.

Consistent with its position in the administrative proceedings, FERC had distinguished the Rule from the regulation of retail demand-response programs (as well as the regulation of generation inputs like fuel) on the ground that the Rule applies only to demand-response providers who directly participate in wholesale markets by seeking payments from wholesale-market operators that are recouped by adjusting wholesale rates. See Pet. App. 8a; see also FERC C.A. Br. 34-40. The court of appeals found that distinction unpersuasive, stating that "the directness of participation may be a function of the richness of the incentives FERC commands" and that FERC's "theory also assumes FERC can 'lure' non-jurisdictional

resources into the wholesale market in the first place to create jurisdiction." Pet. App. 8a.

In light of its concern that FERC's interpretation of Sections 824d and 824e was too expansive, the court of appeals looked for limits "in the context of the overall statutory scheme." Pet. App. 8a. The court focused on Section 824(a)'s statement of policy, which provides that "FERC's reach 'extend[s] only to those matters which are not subject to regulation by the States.'" *Ibid.* (quoting 16 U.S.C. 824(a)). Because "States retain exclusive authority to regulate the retail market," the court reasoned, Sections 824d and 824e could not be read to authorize FERC to regulate demand response in the wholesale market, even though it affects wholesale rates. *Id.* at 8a-10a. The court also read the 2005 EPAct, which established the national policy of eliminating barriers to demand-response programs in electricity markets, to "clarif[y]" that "FERC's authority over demand response resources is limited: its role is to assist and advise state and regional programs." *Id.* at 14a; see *id.* at 11a-14a.

Based on that reasoning, the court of appeals concluded that "the Federal Power Act unambiguously restricts FERC from regulating the retail market" and therefore that, because "[d]emand response * * * is part of the retail market," the Rule was invalid and the court "need not reach *Chevron* step two." Pet. App. 11a, 14a. But the court briefly added that even if "the statute was ambiguous," the court would "find FERC's construction of it to be unreasonable for the same reasons." *Id.* at 14a.

b. The court of appeals further held that "[a]lternatively, even if we *assume* FERC had statutory

authority to execute the Rule in the first place, [the Rule] would still fail because it was arbitrary and capricious." Pet. App. 15a-17a. The court found that FERC had "failed to properly consider—and engage"—Commissioner Moeller's view, "reiterating the concerns" of some commenters, "that [the Rule] will result in unjust and discriminatory rates," which the court believed to be reasonable and persuasive. *Id.* at 15a. The court perceived a "potential windfall to demand response resources" from the Rule's LMP methodology and faulted FERC for not providing a "direct response" to that concern. *Id.* at 16a-17a (citation omitted).

2. Judge Edwards dissented. Pet. App. 17a-48a.

a. Judge Edwards concluded that "FERC's explanation of its jurisdiction under the Federal Power Act is straightforward and sensible." Pet. App. 31a. In FERC's view, he explained, the wholesale-market operators' "rules governing the participation of demand response resources in the nation's wholesale electricity markets are 'practices affecting [wholesale electricity] rates.'" *Ibid.* (brackets in original). He determined that the validity of that position "turn[ed] on a rather straightforward question of statutory interpretation: whether a promise to *forgo* consumption of electricity that would have been purchased in a retail electricity market unambiguously constitutes a 'sale of electric energy' under section [824(b)(1)]," and therefore falls exclusively within the States' jurisdiction. *Id.* at 20a. He found the statute ambiguous on that point and thus would have deferred under *Chevron* to the Commission's interpretation of the FPA. *Id.* at 20a-21a, 34a-35a; see *id.* at 200a. "Absent an affirmative limitation under section [824]," he ex-

plained, "there is no doubt that demand response participation in wholesale markets and the [wholesale-market operators'] market rules concerning such participation constitute 'practice[s] affecting' wholesale rates under section [824e]." *Id.* at 21a.

b. Judge Edwards also concluded that FERC had sufficiently responded to Commissioner Moeller's view that the LMP methodology would overcompensate demand-response providers. See Pet. App. 22a, 42a-48a.

## SUMMARY OF ARGUMENT

The court of appeals erred in vacating the FERC Rule.

I. FERC has legal authority under the FPA to regulate the level of compensation that wholesale-market operators pay for demand-response commitments.

A. The FPA requires FERC to ensure that any "rule, regulation, practice, or contract affecting [a wholesale] rate" is "just and reasonable" and not "unduly discriminatory or preferential." 16 U.S.C. 824e(a); see 16 U.S.C. 824d(a). As the court of appeals acknowledged, the practices at issue here—payments by wholesale-market operators for demand-response commitments—affect wholesale rates. That effect could not be more substantial and direct. The payments are an integral part of setting rates and balancing supply and demand in wholesale auction markets, and they are recouped directly from wholesale purchasers through wholesale rates. That effect is far more immediate than the effect of forgone consumption generally, retail-level demand-response programs, or markets in fuel, steel, and labor. Section

824e(a) therefore on its face authorizes FERC's exercise of authority here.

No other conclusion makes sense of the statutory scheme. No party has contended that wholesale demand-response programs should be left entirely unregulated, and state regulation of the basic rules governing wholesale auction markets would clearly be preempted. The upshot of the court of appeals' conclusion that FERC may not regulate compensation for wholesale demand-response commitments therefore could be that demand-response commitments may not be used in wholesale auction markets at all. But reading the FPA's broad grant of federal jurisdiction over wholesale sales to effectively bar wholesale auction markets from using a resource that reduces wholesale rates and increases system reliability would be an exceedingly counterintuitive reading of a statute designed "to protect power consumers against excessive prices," *Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 418 (1952), and to promote the smooth functioning of the Nation's electricity system.

B. Neither respondents nor the court of appeals identified any plausible support in the statutory text or structure for their constrictive interpretation of the FPA. They pointed to only two provisions—the FPA's declaration of policy, 16 U.S.C. 824(a), and its reservation of state authority over retail sales, 16 U.S.C. 824(b)(1). But the policy declaration does not circumscribe the statute's clear affirmative grants of authority, and the Rule does not regulate retail sales, so those provisions are inapposite.

Respondents essentially read into the FPA an implicit prohibition on FERC regulation—or perhaps any FERC-regulated wholesale-market activity at

all—that significantly affects the "retail market." But that view has FPA preemption backwards: Although the Supremacy Clause prohibits States from enacting laws that directly conflict with FERC policies in the wholesale market, the reverse is not true. See *Northern Natural Gas Co.* v. *State Corp. Comm'n*, 372 U.S. 84, 92-93 (1963). Rather, if a practice directly affects wholesale rates, FERC has the authority—and duty—to ensure that the practice is just and reasonable, 16 U.S.C. 824d(a) and 824e(a), regardless of whether the practice or FERC's regulatory approach also significantly affects the retail market.

C. Even if the statutory-authority question were close, FERC would be entitled to *Chevron* deference. FERC's interpretation of the FPA is at least reasonable, and it is consonant with the purposes of the statute and Congress's 2005 directive to eliminate barriers to demand-response participation in the Nation's electricity markets.

II. The particular compensation level adopted by the Rule—LMP—was the product of reasoned decisionmaking.

A. FERC is entitled to "great deference" in the technical area of ratemaking. *Morgan Stanley Capital Grp. Inc.* v. *Public Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527, 532 (2008). In promulgating the Rule, the Commission engaged in an extensive deliberative process before ultimately settling on the LMP formula. The basic principle animating its decision is that because a commitment to reduce electricity consumption provides the same value to a wholesale market as an equivalent amount of additional generation, they should be compensated identically. That conclusion was supported by sound economic logic, the views

of a renowned expert in the economics of deregulation, comments in the rulemaking record, and the congressional directive to reduce barriers to demand-response participation in the Nation's electricity markets.

B. The court of appeals erred in holding that the Commission failed to sufficiently respond to objections, raised by Commissioner Moeller in dissent and echoed by some commenters, that LMP overcompensates demand-response providers. The Commission directly addressed the same points made by Commissioner Moeller and reached a different conclusion among plausible alternatives.

## ARGUMENT

In holding that FERC lacks authority to regulate the level of compensation paid by wholesale-market operators for demand-response commitments in wholesale markets, the court of appeals seriously misconstrued the Federal Power Act. And in holding in the alternative that the Commission failed to adequately respond to Commissioner Moeller's arguments in favor of a different compensation formula, the court, with almost no explanation itself, overlooked FERC's extensive and sound discussion in its orders of why the LMP formula ensures just and reasonable wholesale-electricity rates. The decision of the court of appeals should be reversed.

### I. FERC HAS AUTHORITY UNDER THE FEDERAL POWER ACT TO PROMULGATE THE RULE

In administering wholesale-electricity auction markets, wholesale-market operators use demand-response commitments to balance supply and demand and set wholesale rates. By securing commitments to

reduce demand rather than adding power supply, wholesale-market operators can reduce wholesale rates and make the market work more efficiently. Pet. App. 59a-61a. The Rule at issue here provides that if a wholesale-market operator uses demand-response commitments, it must pay those resources at the LMP level (provided the net-benefits test is met). See 18 C.F.R. 35.28(g)(1)(v)(A). It also establishes general principles for how payments for demand-response commitments must be recouped in wholesale rates—*i.e.*, they must be allocated proportionally among all wholesale purchasers that benefit from the reduction in rates. 18 C.F.R. 35.28(g)(1)(v)(B). The Rule falls well within the FPA's grant of authority to FERC.

As the court of appeals correctly recognized, the statutory-authority question in this case is governed by the familiar two-step framework of *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). See Pet. App. 5a. Under that framework, a court must first "apply[] the ordinary tools of statutory construction" to "determine whether Congress has directly spoken to the precise question at issue.'" *City of Arlington* v. *FCC*, 133 S. Ct. 1863, 1868 (2013) (quoting *Chevron*, 467 U.S. at 842). If so, that meaning controls. "But 'if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.'" *Ibid.* (quoting *Chevron*, 467 U.S. at 843). That standard applies both to questions about "the scope of the [agency's] delegated authority" and to questions about the "application of its delegated authority." *Id.* at 1870 (emphases omitted).

Accordingly, the question here is "whether the [FPA's] text forecloses [FERC's] assertion of authority." *City of Arlington*, 133 S. Ct. at 1871. It does not. To the contrary, FERC's conclusion that it has the authority to regulate the compensation paid by wholesale-market operators for demand-response commitments is the only sensible reading of the FPA. At minimum, it is reasonable and thus entitled to judicial deference.

### A. FERC Has Adopted The Only Interpretation Of The FPA Consistent With Its Text And Structure

#### *1. The plain text of Section 824e(a) authorizes FERC's exercise of authority*

The Rule is a valid exercise of FERC's paramount authority under Section 824e(a) to regulate rules, regulations, and practices affecting wholesale rates.

a. Section 824e of the FPA is among the FPA's primary grants of regulatory authority to FERC. That section provides in relevant part that "[w]henever the Commission * * * shall find * * * that any rule, regulation, practice, or contract affecting [a wholesale] rate * * * is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable * * * rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." 16 U.S.C. 824e(a); see 16 U.S.C. 824d(a) (proscribing "rules and regulations affecting or pertaining to [wholesale] rates" that are "not just and reasonable").

That text was written at a time when the electricity system was run by vertically integrated monopolies, but now two-thirds of the Nation's electricity load is served by sophisticated auction markets. See pp. 3-6,

*supra*. No party disputes that, as a general matter, the rules, practices, and contracts that wholesale-market operators employ to run those auction markets and operate transmission facilities fall squarely within the grant of authority in Section 824e; they are self-evidently rules, practices, and contracts that affect wholesale rates.

For that reason, each wholesale-market operator has a FERC-approved tariff setting forth the rules that govern its markets. 16 U.S.C. 824d(c) (requiring regulated utilities to maintain on file with FERC "the classifications, practices, and regulations affecting such rates"); see *NRG Power Mktg., LLC* v. *Maine Pub. Utils. Comm'n*, 558 U.S. 165, 169 n.1 (2010). For example, tariffs include intricate instructions for calculating the compensation owed generators under the LMP formula. See, *e.g.*, PJM Tariff, Att. K App. §§ 1.7.7, 2. They also contain detailed rules for determining which entities are eligible to purchase and sell power on the system, *id.* §§ 1.4, 1.5; scheduling and dispatching power, *id.* §§ 1.8, 1.10-1.12; and accounting for electricity purchases and billing purchasers, *id.* § 3.

In like manner, wholesale-market operators also establish parameters for demand-response programs and submit them for FERC approval as part of their tariffs. See, *e.g.*, PJM Tariff, Att. K App. § 3.3A. Those rules govern matters such as the level of compensation for demand-response providers, methods for measuring and verifying the amount of demand reduction, and conditions on accepting demand-response bids.

Just like other rules and practices governing the auction markets, such as the formula for compensat-

ing generators, the methodology for compensating demand-response commitments bid into the wholesale market is a direct determinant of the wholesale rate. Whether set at LMP or some other amount, the compensation level controls which demand-response commitments the computerized system will accept to balance supply and demand, which in turn directly affects the overall market-clearing price of wholesale electricity in the real-time and day-ahead markets. The payments to demand-response providers, moreover, are recouped as an element of the rates paid by purchasers of wholesale electricity—just like payments to electricity suppliers.

Accordingly, like the other facets of the auction markets run by wholesale-market operators, the methodology for compensating demand-response commitments is—under the plain terms of the statute—a "rule, regulation, [or] practice * * * affecting [a wholesale] rate." 16 U.S.C. 824e(a). As a result, FERC has a statutory obligation to ensure that the rules for compensating demand-response commitments in wholesale markets are just and reasonable and result in just and reasonable wholesale rates.

A hypothetical illustrates why the contrary view is untenable. Suppose that a wholesale-market operator was vastly *over*paying for demand-response commitments, choosing to utilize them when it would be far more efficient to pay for additional power generation instead. That overcompensation would inevitably result in higher-than-optimal wholesale rates; the operator would be paying for commitments it does not need to balance supply and demand, and then charging wholesale purchasers to fund those payments. Given that the FPA *requires* FERC to ensure that

wholesale rates are just and reasonable, 16 U.S.C. 824e(a), it is inconceivable that the Commission would lack authority to act in that situation. And if that is so, no convincing basis exists to distinguish the Commission's decision here to set the compensation level for demand-response commitments prospectively to ensure that demand response is neither overused nor underused—and neither overpaid nor underpaid—in light of its important role in securing system reliability as well as efficient and just and reasonable pricing. See Pet. App. 59a-61a.

b. Section 824e(a)'s authorization for FERC to regulate rules and practices "affecting" wholesale rates is not limitless. It cannot reasonably be construed to reach the full range of economic behavior that exerts only an indirect effect on wholesale-electricity rates, even though such activity, in some attenuated sense, "affects" wholesale rates. As with other statutes that delineate their scope with broad phrases like "relating to," the FPA's "affecting" standard, if it were "extend[ed] to the furthest stretch of [its] indeterminacy," would "stop nowhere." *Mellouli* v. *Lynch*, 135 S. Ct. 1980, 1990 (2015) (first set of brackets in original) (internal quotation marks and citation omitted).

For that reason, the D.C. Circuit has held that the Commission's Section 824e(a) authority to regulate rules and practices "affecting" wholesale rates "is limited to those methods or ways of doing things on the part of the utility that *directly affect* the rate or are *closely related* to the rate." *California Indep. Sys. Operator* v. *FERC*, 372 F.3d 395, 403 (2004) (emphasis added). FERC did not dispute that common-sense limitation on its statutory authority in the rule-

making here, and it is amply satisfied for the rules governing the participation of demand-response commitments in wholesale energy markets. See Pet. App. 137a.

The court of appeals, though "agree[ing] with the Commission that demand response compensation affects the wholesale market," expressed the concern that the Commission's construction of its authority under Section 824e "has no limiting principle" and could empower the Commission to regulate retail consumption more generally, or even "the steel, fuel, and labor markets." Pet. App. 7a-8a. That concern was entirely misplaced. Those other areas of economic activity lack a direct effect on wholesale rates. In contrast to those activities, the level at which demand-response providers are compensated by wholesale-market operators for bids into the wholesale system has "about as direct an effect and as clear a nexus with the wholesale transaction as can be imagined." *Id.* at 40a (Edwards, J., dissenting) (quotation marks and citations omitted).

It is undoubtedly true that any reduction in retail demand, including through *retail*-level demand-response programs, exerts an effect on the wholesale market. But in a retail-level demand-response program, the compensation to retail users is not funded by adjusting *wholesale* rates charged in day-ahead and real-time markets, and the demand-response commitments are not selected based on their ability to clear the wholesale market. Rather, the demand-response payments are recouped through adjustments to *retail* rates (potentially over the long term). Only an attenuated chain of causation exists between such

retail-level demand-response payments and wholesale rates.

Even more improbable is the court of appeals' concern that FERC's interpretation of the FPA would authorize it to regulate markets in generation inputs like "steel, fuel, and labor." Pet. App. 8a. Those markets are entirely distinct from markets for electric power. They may indirectly affect the cost of producing electricity, which in turn may affect the bids that suppliers submit to the wholesale-market operators. But wholesale-market operators do not themselves purchase or make payments for fuel or steel. They do pay for demand-response commitments and adjust wholesale rates based on accepted bids. It is that integral relationship that subjects an operator's rules governing demand response to FERC's jurisdiction.

### *2. FERC's interpretation of the FPA is the only sensible understanding of the statutory framework*

For the foregoing reasons, the plain text of Section 824e(a) resolves this case. But FERC's conclusion that it has authority to regulate demand-response payments in wholesale markets is also the only sensible understanding of the statutory framework.

a. No party appears to contend that, if FERC may not regulate the compensation of demand-response commitments bid into wholesale markets, the practice should be left entirely unregulated. The FPA, after all, was enacted to close the regulatory gap created by this Court's dormant Commerce Clause precedents. See *New York* v. *FERC*, 535 U.S. 1, 6 (2002). Reintroducing a gap for such a critical part of the electricity market would flout the statutory design and undercut its foundational purpose, permitting even demand-response programs that harm the public interest. See

pp. 26-27, *supra*. Congress did not enact a regime of "nonregulation" for potential "problem[s]" in the Nation's energy markets. *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 28 (1961).

It is equally clear that wholesale demand-response programs could not be regulated by state utility commissions. In decisions addressing both the FPA and the Natural Gas Act,[6] this Court has made clear that, at minimum, state-law "measures aimed directly at interstate purchasers and wholesales for resale" are preempted. *Oneok, Inc.* v. *Learjet, Inc.*, 135 S. Ct. 1591, 1599-1600 (2015) (quoting *Northern Natural Gas Co.* v. *State Corp. Comm'n of Kan.*, 372 U.S. 84, 94 (1963)). As this Court held fifty years ago, "[t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result." *Northern Natural Gas*, 372 U.S. at 91 (internal citation omitted); see, *e.g.*, *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 306-308 (1988) (holding preempted a state law capping a natural gas company's equity levels in order to suppress wholesale rates).

The level of compensation that wholesale-market operators pay for demand-response payments is not merely some general feature of the broader economy that exerts an incidental effect on wholesale rates. Rather, it is a critical part of the rules that wholesale-market operators use to establish a market-clearing

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[6] Because the relevant provisions of the FPA and the Natural Gas Act "are in all material respects substantially identical," this Court "cit[es] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas La. Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981) (citation omitted).

price. See pp. 25-26, *supra*. It would deeply interfere with the rate-setting process if each state utility commission could adopt its own idiosyncratic rules for how demand-response compensation is calculated by wholesale-market operators. As one set of respondents have themselves explained, "a state may not manipulate prices in the federally regulated wholesale market." Br. in Opp. at 20, *Nazarian* v. *PPL EnergyPlus, LLP*, No. 14-614 (Feb. 11, 2015).[7]

It would be even more disruptive if state commissions could also adopt different and potentially irreconcilable rules governing such related matters as how the cost of the payments is distributed among wholesale ratepayers and the measurement and verification protocols that wholesale-market operators must adopt. Such a scenario would produce immense complexity for multi-state wholesale-market operators, and could even prompt them to abandon using demand-response resources altogether. See California ISO Br. in Support of Cert. 16. That kind of extraordinary intrusion into the operations of organized wholesale electricity markets would certainly be preempted.

b. Because state regulation of wholesale demand-response programs would be preempted (as well as utterly impracticable), and because a total regulatory vacuum is unthinkable, depriving FERC of authority to regulate the rules and practices at issue here could mean that wholesale-market operators may not implement demand-response programs *at all*. After all, a principal jurisdictional concern of the court of ap-

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[7] This brief uses the term "respondents" to refer to the respondents that filed a brief in opposition at the certiorari stage. This Court has called for the views of the Solicitor General in *Nazarian*.

peals—that the Rule "lures" retail actors into the wholesale market, Pet. App. 8a—arguably would also apply to FERC's mere authorization, through tariff approvals, of any compensation for demand-response commitments bid into wholesale markets. And in any event, if FERC were legally barred from ensuring that wholesale demand-response practices are just and reasonable and produce just and reasonable wholesale rates, it could be driven to bar wholesale-market operators from accepting demand-response bids altogether.

Respondents, in fact, appear to acknowledge that the upshot of their statutory arguments could be that demand-response programs in wholesale auction markets are flatly unlawful, although they have not been entirely clear on that question in this case. See Br. in Opp. 15, 31-32, 37-38. Respondents did not challenge FERC's Order No. 719, which requires wholesale-market operators to provide for demand-response participation by retail aggregators and for ancillary services (see p. 11, *supra*). But in response to FERC's warning in its petition for rehearing in this case that the panel's decision could be read to "invalidat[e] all demand response participation at any compensation level * * * in any wholesale market," Pet. for Reh'g 14, respondents offered only that wholesale purchasers could enter into bilateral demand-response contracts with retail customers and that retail customers could participate in retail-level programs. Electric Power Supply Association (EPSA) C.A. Opp. to Pet. for Reh'g 12-13. Those measures are not remotely equivalent to the sophisticated use of demand-response bids in wholesale auction markets addressed by the Rule.

To hold that the FPA implicitly prohibits wholesale auction markets from accepting demand-response bids, or leaves the compensation and related matters unregulated, would be a counterintuitive and self-defeating interpretation of the FPA's broad grant of federal authority. FERC detailed in its order the substantial benefits that demand-response participation confers on wholesale markets in terms of lowering wholesale rates, increasing system reliability, and curbing the market power of generators. See Pet. App. 59a-61a, 189a-190a. That conclusion echoed the widespread view of commenters (who also described other significant benefits, such as positive environmental effects), including those who opposed the Rule's compensation formula on the merits. See, *e.g.*, J.A. 237-238, 252-253, 353, 405, 441, 468, 562, 577, 601-605, 659. Dissenting Commissioner Moeller likewise acknowledged that there was "no debate" that "demand response plays a very important role in these markets by providing significant economic, reliability, and other market-related benefits." Pet. App. 156a. Indeed, respondents themselves told FERC that "[w]ell-functioning wholesale competitive markets should include appropriately-designed economic [demand response] and other load response programs," R.45, Comments of the PPL Parties 2 (May 13, 2010), and professed that they "fully support[] participation by diverse resources, including [demand response] resources, in wholesale energy markets administered by [wholesale-market operators]" because it "can provide efficiency benefits (both economic and operational)," J.A. 1000; see J.A. 82, 94-95, 170, 392, 396, 617.

Given that demand-response programs unquestionably confer significant benefits on wholesale markets, including lower rates, there is no defensible justification for concluding that the FPA nevertheless altogether excludes the programs from wholesale markets or FERC regulation. That destructive result would frustrate the basic objectives of the statute. As this Court has recognized for decades, the core purposes of the FPA are "to protect power consumers against excessive prices," *Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 418 (1952), and "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce," *Gulf States Utils. Co.* v. *FPC*, 411 U.S. 747, 758 (1973). Expelling a price-reducing, reliability-enhancing practice or regulation from wholesale markets would be inimical to those goals.

c. It is true that there was no obvious analogue to demand-response compensation in wholesale markets when the FPA was enacted in 1935. And it can be fairly said that the practice in certain respects straddles the wholesale-retail divide in a way that could not have been envisioned before the rise of modern wholesale auction markets. Cf. *Oneok*, 135 S. Ct. at 1601 (rejecting the argument that "there is, or should be, a clear division between areas of state and federal authority" as no more than a "Platonic ideal"). It is therefore no surprise that the text of the FPA does not address wholesale demand-response programs beyond the general grant of authority to FERC to regulate rules and practices affecting wholesale rates contained in Section 824e(a).

But Congress wrote the FPA and the Natural Gas Act in deliberately capacious terms, see *FPC* v. *Hope*

*Natural Gas Co.*, 320 U.S. 591, 611 (1944), which gives the Commission the flexibility to adapt its regulatory approaches to technological and economic developments. Thus, although "the landscape of the electric industry has changed since the enactment of the FPA, * * * the plain language of the FPA readily supports FERC's claim of jurisdiction." *New York*, 535 U.S. at 16 (internal quotation marks omitted).

There certainly "is no evidence that if Congress had foreseen the developments to which FERC has responded, Congress would have objected to FERC's interpretation of the FPA." *New York*, 535 U.S. at 23. To the contrary, in 2005 Congress established as "the policy of the United States that * * * unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated." EPAct § 1252(f), 199 Stat. 966. That broad directive was not limited to retail-level demand-response programs, and wholesale markets were actively implementing demand-response programs when Congress enacted that policy. Indeed, "capacity and ancillary service markets" are established components of the wholesale system, so Congress clearly had wholesale markets in mind when it directed the removal of demand-response barriers.

In short, given the FPA's broad grant of federal jurisdiction and basic purposes, and Congress's more recent efforts to encourage the growth of demand-response programs, the court of appeals' construction of the FPA to bar FERC from regulating the compensation for demand-response commitments cannot be justified.

### B. Respondents' Arguments Lack Support In The FPA

#### *1. No provision of the FPA circumscribes FERC's authority to regulate wholesale demand-response payments*

No other provision of the FPA circumscribes FERC's Section 824e(a) authority to regulate demand-response payments by wholesale-market operators. Respondents have identified only two assertedly relevant provisions, but neither applies here.

a. *The FPA's policy declaration.* The principal textual provision on which the court of appeals relied was the FPA's declaration of policy. Pet. App. 8a-9a. That provision states that federal regulation of "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest," but that "such Federal regulation * * * extend[s] only to those matters which are not subject to regulation by the States." 16 U.S.C. 824(a). That declaration is fully consistent with—indeed it supports—FERC's exercise of authority here because wholesale demand-response payments are "not subject to regulation by the States." See pp. 30-31, *supra*.

But even if there were some tension between the general statement of policy and the specific grant of authority to FERC in Section 824e(a), the latter would control. This Court has long held that "the precise reserved state powers language" in Section 824(a) is "a mere policy declaration that cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose." *New York*, 535 U.S. at 22 (quoting *FPC* v. *Southern Cal. Edison Co.*, 376 U.S. 205, 215 (1964)

(quoting *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 527 (1945))) (internal quotation marks omitted); cf. *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 637 n.14 (1972) (Natural Gas Act). The function of Section 824(a) is to frame, at a high level, the general structure and purpose of the FPA, which are then carried into execution by the statute's operative provisions. It is not to diminish the "clear and specific grant[s] of jurisdiction" to FERC elsewhere in the statute, such as Section 824e. See *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354, 383 (1988) (*Mississippi Power*) (Scalia, J., concurring in the judgment).

The court of appeals concluded that Section 824e does "not constitute a 'clear and specific grant of jurisdiction'" and therefore does not suffice to sustain the Rule. Pet. App. 9a. That unexplained holding cannot be reconciled with the FPA's text or this Court's decisions. Section 824e is a foundational grant of ratemaking authority to FERC. This Court has never drawn a distinction between, on the one hand, FERC's authority over rates and, on the other, its authority over rules, regulations, and practices "affecting" rates—which appear in the same sentence of Section 824e(a). To the contrary, this Court has repeatedly instructed that "FERC's exclusive jurisdiction applies not only to rates" but also to matters "that affect wholesale rates." *Id.* at 371 (opinion of the Court); see *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 966-967 (1986) (*Nantahala*); *Schneidewind*, 485 U.S. at 308-309 (Natural Gas Act). Thus, for example, in *Nantahala* and *Mississippi Power*, the Court gave preemptive effect to the Commission's approval of contracts setting power alloca-

tions, and did not distinguish between FERC's authority over rates and its authority over contracts "affecting" rates. *Mississippi Power*, 487 U.S. at 374; see also *Nantahala*, 476 U.S. at 966-67. It is therefore difficult to understand the basis for the court of appeals' conclusion that Section 824e does not constitute a sufficiently clear grant of authority to prevail over the court's tenuous inference from the FPA's declaration of policy.

It is true that Section 824(a) may be consulted to resolve "any ambiguity or indefiniteness in the specific provisions which purport to carry out its intent." *Connecticut Light & Power*, 324 U.S. at 527. But there is no ambiguity here. As explained above, the rules that wholesale auction markets employ to set rates and balance wholesale supply and demand have a direct and substantial effect on wholesale rates and therefore clearly fall within the Commission's authority under Section 824e(a). No other operative provision of the FPA even suggests that demand-response bids are entirely prohibited in wholesale auction markets or beyond FERC's authority to regulate. Such a significant prohibition could not reasonably be inferred from the statute's general policy declaration—especially when read in light of Congress's 2005 directive that barriers to demand response be eliminated. See EPAct § 1252(f), 119 Stat. 966. And in any event, were the FPA sufficiently ambiguous as to the statutory-authority question to necessitate resort to its general purposes, the Commission would be entitled to *Chevron* deference. See pp. 44-45, *infra*.

b. *Reservation of State authority over retail sales.* Section 824(b)(1) reserves to the States authority over, *inter alia*, non-wholesale sales of electricity (*i.e.*,

retail sales). See p. 4, *supra*. At one point in their brief in opposition, respondents suggested that Section 824(b)(1) prohibits FERC from regulating demand-response compensation in wholesale markets, see Br. in Opp. 16-19, although elsewhere they seemed to disclaim reliance on that provision, see *id.* at 23-24.

Tellingly, the court of appeals expressly held that it did "not base [its] conclusion" on Section 824(b)(1), Pet. App. 9a n.1, and it is easy to see why: A commitment to refrain from taking electricity from the system "does not involve a sale" at all—it is a promise *not* to make a retail purchase. *Id.* at 6a; accord *id.* at 35a (Edwards, J., dissenting) ("There was no sale, period."). Accordingly, when FERC prescribes the formula that a wholesale-market operator must use to compensate demand-response commitments, it has not dictated the terms of any retail sale and so has not transgressed the limit reflected in Section 824(b)(1). That provision therefore does not aid respondents' argument.

At the same time, Section 824(b)(1) does refute some of respondents' more extreme hypotheticals. Respondents claim, for example, that under FERC's interpretation of the FPA, "FERC could strip States of all jurisdiction to regulate retail sales merely by inviting all retail customers to purchase power directly from the wholesale markets." Br. in Opp. 21. But ousting all state jurisdiction simply by allowing retail customers to purchase power in organized wholesale markets *would* violate the reservation of state authority over retail sales in Section 824(b)(1). Nothing about FERC's exercise of authority over demand-response commitments in wholesale markets could be used as support for such an unlawful regime.

In a similar vein, the court of appeals hypothesized a demand-response program in which wholesale-market operators would somehow provide credits on retail bills "to any consumer who reduced its expected use of retail electricity" (rather than only those consumers who make bids into wholesale markets). Pet. App. 11a. Not only would such a program lack a direct connection to wholesale rates (see pp. 27-29, *supra*), it would run headlong into Section 824(b)(1) by directly altering the terms of retail sales through reductions in the payments owed to local utilities. The mere fact that an alternative demand-response compensation scheme could be imagined that violates Section 824(b)(1) does not mean that the programs actually addressed by the Rule overstep the limits of the FPA.

***2. The FPA does not bar FERC from regulating practices that affect the retail market***

For the foregoing reasons, the two provisions of the FPA on which respondents rely are facially inapposite. Ultimately, however, respondents' core argument is not so much that the Commission's exercise of authority violates any *express* limit in the FPA, but rather that the cited provisions reflect an implicit structural limit on FERC's authority to regulate—or perhaps even permit—practices that significantly affect the "retail market." Br. in Opp. 15; see Pet. App. 2a, 8a-14a.

That position misunderstands how the FPA works. Aside from affirmative limitations set out in Section 824(b)(1), the FPA does not subordinate FERC's authority over wholesale markets to state-law policies formulated for the retail market. See *Northern Natural Gas Co.*, 372 U.S. at 92-93. Rather, if FERC has

authority over a practice because it directly affects wholesale rates, 16 U.S.C. 824e(a), and the practice is not expressly excluded from FERC's jurisdiction, the Commission must ensure that the practice results in just and reasonable wholesale rates, even if the practice, or the Commission's regulation of the practice, also affects the retail electricity market. See *FPC* v. *Conway Corp.*, 426 U.S. 271, 281 (1976) ("The rules, practices, or contracts 'affecting' the jurisdictional rate are not themselves limited to the jurisdictional context."). Respondents' structural arguments overlook that principle.

a. Respondents argue that by prescribing a compensation formula for wholesale-demand response payments, FERC is altering the "retail rate." Br. in Opp. 18. Respondents do not literally mean that FERC is changing the retail rate set by state utility commissions, which it may not do under Section 824(b)(1). See *Conway Corp.*, 426 U.S. at 276. As States supporting FERC have explained, the Rule "does not change a single retail rate." Joint State Br. in Support of Cert. Br. 9. Rather, respondents contend that FERC has changed the "effective" rate faced by a retail user because a purchase of power now effectively costs the user the retail rate *plus* the forgone demand-response payment. Br. in Opp. 18.

Respondents' analysis is wrong. Wholesale demand-response programs certainly change the incentives of some purchasers in the retail market (*i.e.*, those users that have the desire and capacity to make bids into wholesale auction markets and are permitted to do so by the relevant state authority). But that effect on the retail market does not deprive FERC of jurisdiction that otherwise falls within the

plain text of Section 824e(a). Although the Supremacy Clause bars States from implementing policies that directly affect wholesale rates or the wholesale market, see pp. 30-31, *supra*, the reverse is not true: If a practice directly affects the wholesale market and also affects retail markets, FERC has the authority, and the duty, to ensure that it is just and reasonable. Thus, for example, the power allocations at issue in *Nantahala* and *Mississippi Power* exerted a significant effect on both wholesale and retail rates, yet this Court concluded that FERC's orders preempted inconsistent ratesetting orders of state utility commissions. See *Nantahala*, 476 U.S. at 959, 972-973; *Mississippi Power*, 487 U.S. at 366-367, 376-377. So too here: Wholesale demand-response programs are direct determinants of wholesale rates; the fact that they influence retail-user incentives does not strip FERC of its statutory authority. See *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 603 (1945) (upholding Commission's rate "treatment of [non-jurisdictional natural-gas] producing properties and gathering facilities [which] had of course an indirect effect on them").

b. Respondents have relatedly argued that the Commission's decision to regulate the level of compensation for demand-response commitments in wholesale markets "unreasonably interfere[s] with existing state and local programs addressing retail customer 'demand response' and with state policy choices not to implement such programs at this time." EPSA C.A. Br. 41. Here again, respondents do not literally mean that the Rule modifies state-level retail demand-response programs. The Rule does not address those programs, and FERC has not asserted

regulatory authority over retail-level efforts. See Pet. App. 59a.

What respondents appear to mean instead is that the Rule addresses a problem—the fact that electricity demand generally is not responsive to price increases—that stems in part from state regulatory choices. See Pet. App. 97a. If state authorities allowed retail rates to fluctuate freely with increases in wholesale rates, retail customers might be more responsive to large increases in the cost of generating electricity at peak times, and thus demand would naturally decrease as the price of supplying power increased during those periods. Wholesale-market operators might then have a reduced need for demand-response programs. Thus, the argument seems to go, by regulating demand-response compensation in wholesale markets, FERC is invading the States' exclusive authority to determine whether electricity demand should be responsive to wholesale prices. See Br. in Opp. 17-18.

That argument rests on a fundamental misunderstanding of both the Rule and the FPA. In the first place, neither the Rule nor any other FERC order requires wholesale-market operators to allow participation in demand-response programs in wholesale energy markets where state law prohibits that practice by retail customers—whether because of retail demand-response programs at the state level or for some other reason. See p. 11, *supra*. But in any event, the FPA nowhere deprives FERC of all authority over electricity demand or suggests that such activity is within the exclusive province of the States. Rather, it *grants* FERC authority over practices directly affecting wholesale rates, 16 U.S.C. 824d(a),

824e(a), while depriving FERC only of jurisdiction over retail *sales*, 16 U.S.C. 824(b)(1). Before the rise of modern wholesale auction markets, it might have been the case that no practice promoting a reduction in electricity demand would have borne a significantly close relationship to wholesale rates to justify the exercise of federal authority. Cf. *New York*, 535 U.S. at 16. Now that the markets' sophisticated systems are able to use commitments to reduce demand to set wholesale rates in real time, balance supply and demand, and make their systems more reliable and efficient, no sound basis exists to conclude that that practice lies outside of FERC's authority. If respondents believe that these technological advances and economic developments warrant a new affirmative restriction on FERC's authority, they should direct their concerns to Congress.

### C. At Minimum, FERC's Interpretation Of Its Statutory Authority Is Entitled To *Chevron* Deference

Even if the FPA were ambiguous as to whether FERC may regulate wholesale-market operators' rules governing how demand-response providers participate in wholesale-electricity markets, the Commission would be entitled to deference at *Chevron* step two.

At minimum, the text of the FPA does not "unambiguously foreclose[] the agency's interpretation" of its statutory authority. *National Cable & Telecomm. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 982-983 (2005) (*Brand X*). The pertinent features of the FPA are a broad grant of jurisdiction to FERC over all practices "affecting" wholesale rates, 16 U.S.C. 824e(a); the denial of federal jurisdiction over retail sales, 16 U.S.C. 824(b)(1); and a policy statement

reserving those matters to the States that are not given to FERC, 16 U.S.C. 824(a). Those do not add up to a clear statutory proscription of the authority FERC has exercised in the Rule. There can be no serious debate that the practices here directly and substantially affect wholesale rates under Section 824e(a). See pp. 25-27, *supra*.

Even were it arguable that Sections 824(a) and 824(b)(1) withdraw the authority facially conferred by Section 824e(a), the statute would at most be ambiguous on the point. See Pet. App. 37a-38a (Edwards, J., dissenting). Accordingly, the question would be whether FERC's interpretation is "within the bounds of reasonable interpretation." *Michigan* v. *EPA*, No. 14-46 (June 29, 2015), slip op. 6 (citation omitted). For all the reasons given above, FERC's interpretation is reasonable. And it embodies a sensible approach to regulation that furthers the national policy reflected in the EPAct. By exercising authority over wholesale demand-response programs, FERC can ensure that a practice that occurs in wholesale markets, and has been widely recognized as tremendously important to the efficient functioning of those markets, will continue to provide benefits to consumers and the economy and is deployed in a way that results in just and reasonable wholesale rates and a reliable electricity system. That plainly is a reasonable interpretation of FERC's statutory authority entitled to deference.

## II. FERC REASONABLY EXPLAINED ITS DECISION TO ADOPT THE LMP FORMULA

The court of appeals held that, even if FERC has statutory authority to promulgate the Rule, the Commission did not sufficiently consider and respond to arguments by Commissioner Moeller and some commenters that the LMP formula the Rule adopts would overcompensate demand-response providers. Pet. App. 15a. That holding was erroneous. The Commission "articulate[d] a satisfactory explanation" for adopting the LMP formula. *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009) (internal citation omitted). Respondents' criticisms of the Rule demonstrate only that reasonable minds can differ about exceedingly technical questions of energy regulation and economics that are inextricably intertwined with policy judgments.

### A. FERC Thoroughly Evaluated The Competing Arguments And Reasonably Explained Its Decision To Adopt The LMP Formula

1. When a party challenges an agency's rulemaking under the Administrative Procedure Act (APA), 5 U.S.C. 701 *et seq.*, a court must uphold the rule unless it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). It is axiomatic that the "scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency." *Motor Vehicle Mfrs. Ass'n of the United States, Inc.* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). A regulation or order must be sustained so long as the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action[,] including a rational connection be-

tween the facts found and the choice made." *Ibid.* (internal quotation marks and citation omitted).

Those bedrock principles of administrative deference have special force in a technical area like electricity ratemaking. See *Brand X*, 545 U.S. at 1002-1003. Because "[t]he statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition," this Court "afford[s] great deference to the Commission in its rate decisions." *Morgan Stanley Capital Grp. Inc.* v. *Public Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527, 532 (2008). "[T]he Commission is not bound to any one ratemaking formula," *ibid.*, and judicial "review is highly deferential" because "[i]ssues of rate design are fairly technical and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission" of the Commission, *Alcoa Inc.* v. *FERC*, 564 F.3d 1342, 1347 (D.C. Cir. 2009) (internal quotation marks and citation omitted; brackets in original); see *Aluminum Co. of Am.* v. *Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 390 (1984).

2. FERC engaged in a "logical and rational" deliberative process in which it considered various approaches and ultimately adopted the LMP formula, a reasonable choice among plausible alternatives. *Michigan*, slip op. 5.

a. In the NPRM, FERC proposed the LMP formula on the ground that "paying demand response resources the LMP in all hours will compensate those resources in a manner that reflects the marginal value of the resource to each [wholesale-market operator], comparable to the treatment of generation resources." J.A. 35. In other words, because a reduction in demand provides the same benefits to a wholesale sys-

tem as an equivalent increase in supply, it should be compensated equivalently. The Commission explained its concern that wholesale-market operators that were compensating demand-response commitments at levels less than LMP were causing "under-investment in demand response resources, resulting in higher, and unjust and unreasonable, prices in the organized electricity markets." J.A. 35-36.

The Commission cited as key support for its proposal in the NPRM an affidavit submitted in an earlier FERC proceeding by Dr. Alfred E. Kahn, one of the Nation's foremost experts on the economics of deregulation. See J.A. 37.[8] In that affidavit, Dr. Kahn explained that "[t]he (incremental) costs saved by curtailments in demand clearly will be the full LMP" and therefore that "full LMP inducement is the economically correct one." J.A. 1340. He further explained that LMP "pricing maximizes net social welfare": "the customers who agree to curtail their usage at peak times are better off because, as is demonstrated by their acceptance of the bids, the value of that compensation to them outweighs the inconvenience of curtailing their usage," and "[a]ll the remaining subscribers are better off as well, because the curtailment of usage reduces, or holds down, the incremental cost of continuing to serve all." J.A. 1344-1345.

The NPRM, however, also recognized that "the appropriate level of compensation for demand response resources participating in organized wholesale

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[8] Dr. Kahn, who passed away in 2010, was the author of the influential two-volume treatise *The Economics of Regulation: Principles and Institutions* (1970), and was a former chair of the Civil Aeronautics Board. J.A. 1337. The record in the prior proceeding was incorporated into this rulemaking. J.A. 43.

energy markets has been the subject of debate." J.A. 39. FERC accordingly sought public comment on (among other issues) "alternative approaches to compensating demand response resources." J.A. 41.

In response to the NPRM and a supplemental NPRM, numerous parties submitted public comments, and FERC held a technical conference. Pet. App. 66a-67a. Although there was widespread agreement that demand-response commitments are an important component of modern wholesale-electricity markets (see p. 33, *supra*), the commenters disagreed as to whether LMP was the best choice for the level of compensation. Manufacturers, demand-response providers, and other major power users, like the large retailer Walmart, supported LMP because the alternative approaches would not "compensate demand response for the value it brings to the wholesale market." J.A. 455; see, *e.g.*, J.A. 234, 369, 566-569, 588; see also, *e.g.*, R.9, Comments of Industrial Energy Consumers of America 2 (May 4, 2010); R.31, Comments of the American Chemistry Council 2 (May 13, 2010); R.32, Comments of the National Electrical Manufacturers Association 3 (May 13, 2010). Dr. Kahn also submitted a supplemental affidavit explaining that demand response "is in all essential respects economically equivalent to supply response * * * [so] economic efficiency requires * * * that it should be rewarded with the same LMP that clears the market." J.A. 830; see Pet. App. 69a.

Generators of electricity, wholesale-market operators, some state commissions, the Federal Trade Commission, and others supported variations of a formula (called LMP-G) in which LMP would be reduced by a portion of the retail rate that the demand-

response provider avoids by forgoing the purchase of power. See, *e.g.*, J.A. 149, 239, 283, 306, 407-408, 526, 538, 622. Citing experts, they maintained that "paying LMP, rather than LMP-G, leads to distorted price signals and thus causes some customers to reduce energy usage to below-optimal levels, or others to increase usage to above-optimal levels." Pet. App. 213a. Some commenters also believed that the Commission should not adopt a uniform approach but should allow wholesale-market operators to continue to adopt their own methodologies. See, *e.g.*, J.A. 942.

b. FERC then issued the Rule adopting the LMP formula, but explaining that "the record leads us to alter the proposal" to address concerns raised by commenters. Pet. App. 92a; see *id.* at 89a-104a. FERC recognized that a decrease in demand "may result in an increased cost per unit * * * to the remaining wholesale load associated with the decreased amount of load paying the bill"—a phenomenon that FERC called the "billing unit effect." *Id.* at 55a; see *id.* at 53a-56a, 92a-93a. FERC therefore imposed a net-benefits test, which requires a wholesale-market operator to pay LMP only if it will result in a net "reduction in the total amount consumers pay" for power. *Id.* at 93a-95a; see also, *e.g.*, J.A. 378-380 (comment suggesting similar approach). Thus, demand-response commitments must be paid LMP only when doing so will benefit purchasers overall.

FERC also addressed in the initial order and the order on rehearing why it was selecting the LMP formula over the LMP-G formula. See Pet. App. 99a-102a, 213a-214a. The Commission explained that it does not typically "inquire into the costs or benefits of production for the individual resources participating

as supply resources in the organized wholesale electricity markets." *Id.* at 101a. Put another way, the Commission does not vary the price paid to generators of electricity based on differences in the generators' individual costs of producing electricity. The Commission saw no economically justifiable reason to treat demand-response providers differently. *Ibid.* Like generators, FERC concluded, they should be paid for the value of their contribution to the wholesale system. The Commission emphasized that application of the net-benefits would ensure that demand-response resources are paid LMP only when doing so would benefit purchasers. See *id.* at 217a-221a.

Consistent with the national policy set forth in the EPAct, FERC also found that paying LMP would address various technological, regulatory, and economic "barriers to potential demand response providers," which would "lead to increased levels of investment in and thereby participation of demand response resources." Pet. App. 99a; see *id.* at 97a-98a, 214a-217a. Commenters had detailed the significant start-up costs for companies that wish to provide demand-response commitments to wholesale markets and the inadequacy of current compensation levels to spur the necessary investments. See J.A. 356 (Comments of Viridity Energy) (noting the "capital investments and operational changes needed to participate in the energy market with demand response"); J.A. 457-458 (Comments of EnerNOC) (explaining that "the inadequate compensation mechanisms in place today fail to induce sufficient investment in demand response resource infrastructure and expertise"); see also J.A. 565 (Comments of Wal-Mart Stores). The Commission added that by making demand-response re-

sources more competitive with generation resources, paying LMP would "enhance the competitiveness of organized wholesale energy markets." Pet. App. 99a, 222a.

c. FERC considered but ultimately rejected arguments against prescribing a single compensation formula to govern all wholesale-market operators. See Pet. App. 87a-89a, 104a. Although the Commission acknowledged that "differences in market structure, state regulatory environment, and resource mix among the [wholesale-market operators]" exist, it found that "the commenters ha[d] not shown why such differences warrant a different compensation level." *Id.* at 104a. The regional differences, the Commission explained, do not change the fact that "payment of LMP represents the marginal value of a decrease in demand." *Ibid.*

3. FERC's adoption of the LMP formula was "reasonable and reasonably explained." *North Baja Pipeline, LLC* v. *FERC*, 483 F.3d 819, 820 (D.C. Cir. 2007).

The central insight of the Rule, supported by Dr. Kahn's expert analysis and the views of commenters, is that in organized wholesale energy markets a commitment to reduce demand is identical, for economic purposes, to additional supply that could satisfy the same amount of demand. See Pet. App. 101a-102a, 212a, 217a-220a. A reduction in demand, the Commission concluded, brings the same value to an organized wholesale energy market as an equivalent increase in supply. Using the same payment formula (LMP) thus ensures that a wholesale-market operator will do whatever is more efficient—purchasing additional supply or purchasing reduced demand—to balance the

system. See *id.* at 219a-220a. That sound analysis reflects reasoned decisionmaking.

That is not to say that FERC would have acted arbitrarily in adopting LMP-G. This "Court has repeatedly held that the just and reasonable standard does not compel the Commission to use any single pricing formula," but rather "accords it broad ratemaking authority." *Mobil Oil Exploration & Producing Se., Inc.* v. *United Distrib. Cos.*, 498 U.S. 211, 224 (1991). Both LMP and LMP-G fall well within the bounds of reasoned agency decisionmaking.

The example that Commissioner Moeller discussed (Pet. App. 161a-162a) can be used to illustrate that point. He posited a generator and a demand-response provider that both submit successful bids and are paid the LMP rate of $100, with the demand-response provider ordinarily paying a retail rate of $25. Commissioner Moeller stated that because "the Rule effectively ignores the fact that the demand resource will actually receive a total compensation of LMP+G ($125) as a result of its decision not to consume," the provider effectively receives more compensation ($125) than the generator ($100). *Id.* at 162a.

But critically, neither of those figures reflects the *actual net gain*—and hence incentive—faced by either the demand-response provider or the generator. The generator incurs costs in generating electricity, so its net gain is $100 minus those costs. See J.A. 579. And as FERC noted, certain generators, like renewable-energy providers, might even receive tax credits or other incentives for producing electricity, reducing their costs. Pet. App. 219a n.122; see J.A. 360.

Likewise, the demand-response provider (say, a factory) incurs costs when it refrains from taking

power from the grid—for example, the cost of obtaining power from another source, such as a standby generator, or the cost of going without the forgone power in its production of goods for a period of time—in addition to the cost of technology necessary to participate in wholesale markets. See J.A. 249-251 (Comments of Verso Paper); J.A. 372-384 (Comments of Viridity Energy); J.A. 449 (Comments of Steel Producers); J.A. 565 (Comments of Wal-Mart Stores). Those costs may be only partially offset by not having to pay the $25 retail rate during the demand-response period. Moreover, demand-response providers may receive a diminished offset from the forgone retail payments, or no offset at all, because they will simply shift their power use to an off-peak period, and pay the retail rate for that period instead. See J.A. 607 (Comments of Public Interest Organizations). Like the generator, then, the provider's net gain is $100 minus the costs incurred in going without power for a period of time; those costs may or may not be reduced as a result of the forgone $25 retail rate, just like a generator's costs may or may not be reduced by a tax credit.

In adopting the LMP formula, the Commission applied a principle of symmetry: Because it does not ordinarily take into account the costs of production in paying generators LMP, it would not take into account a demand-response provider's costs either—including the degree to which those costs are offset by the savings from forgoing payment of the retail rate. See Pet. App. 101a-102a, 219a-222a, 229a. In other words, the Commission viewed a reduced retail bill as simply one component of the cost of providing a demand-response commitment. Commissioner

Moeller, in line with the view of certain commenters, would have instead classified the unpaid retail rate as part of the compensation received for the demand-response commitment—even though that "compensation" is not paid by the wholesale-market operator that accepts the demand-response bid. See *id.* at 161a-163a, 273a-274a.

There is no indisputably correct choice as between those two approaches. But FERC reasonably concluded that paying only LMP-G would underutilize demand-response commitments, resulting in higher wholesale rates and impeding investment in demand-response programs and infrastructure. That conclusion lies well "within a 'zone of reasonableness.'" *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942)); see *Conway*, 426 U.S. at 278. Take again Commissioner Moeller's example of a $100 LMP and a $25 retail rate. Suppose it costs a factory $120 to go without power during the period of a demand-response commitment. If the compensation formula is LMP-G, the factory would receive only $75 for a demand-response commitment. Even with the $25 savings from the forgone retail payment, that would not be a sufficient incentive to make a demand-response bid that would clear the system. But if the factory is paid LMP, it *would* make a demand-response bid that could clear the system, because the payment of $100 for providing demand response exceeds the net cost of $95 (*i.e.*, $120 minus $25) for going without power. And if accepting the bid will make wholesale purchasers better off overall (as required by the net-benefits test), the wholesale-market operator will accept the demand-response bid to bal-

ance its system. That would not happen under the LMP-G formula, because the bid never would have been submitted.

The APA supplies no sound basis to reject FERC's reasoned judgment on this matter, which is exceedingly technical and requires expert regulatory and policy judgment, and which FERC resolved after weighing the conflicting recommendations of experts and industry participants. As with other regulatory decisions that "require[] a high level of technical expertise," this Court should "defer to the informed discretion of the responsible federal agenc[y]." *Marsh* v. *Oregon Natural Res. Council*, 490 U.S. 360, 377 (1989) (quotation marks and citation omitted).

4. Although the court of appeals did not reach the issue, respondents made a series of arguments below that the Commission had acted arbitrarily in adopting a single standard to govern all wholesale-market operators. For example, respondents argued that the Commission had not demonstrated that the other methodologies were unjust and unreasonable, see EPSA et al. C.A. Br. 61-65, and that the Commission had unreasonably departed from prior decisions approving other compensation methodologies, see *id.* at 50-52.

Those arguments lack merit. In the early years of wholesale demand-response programs, the Commission permitted wholesale-market operators to experiment with different compensation methodologies. Pet. App. 63a. In 2008, the Commission asked operators to study whether reforms were necessary to remove artificial barriers to demand-response participation in wholesale markets. See p. 11, *supra*. The Commission then undertook this rulemaking precisely to de-

termine whether one compensation methodology would best promote the efficiency and reliability of the wholesale-electricity system, and, after extensive public comment and consideration, the Commission adopted the LMP formula. The Commission determined that where the Rule's conditions (*e.g.*, the net-benefits test) are met, "payment by [a wholesale-market operator] of compensation other than the LMP is unjust and unreasonable." Pet. App. 91a; see *id.* at 224a. And it found that any differences among wholesale-market operators were not relevant to whether LMP is the superior compensation formula. See *id.* at 104a, 224a-227a. Those discussions plainly "display[ed] awareness that [FERC was] changing position" with respect to whether a single standard was necessary and identified "good reasons for the new policy." *Fox Television Stations*, 556 U.S. at 515.

### B. FERC Sufficiently Responded To Commissioner Moeller's Arguments

The court of appeals held that the Rule must be set aside on the ground that the Commission failed to sufficiently respond to Commissioner Moeller's concerns about overcompensation. Pet. App. 15a-17a. But the court provided very little explanation itself for why it believed that the Commission's extensive analysis, which responded to the arguments of commenters aligned with Commissioner Moeller, was deficient. See *ibid.* In fact, FERC squarely responded to each of the principal points made by Commissioner Moeller with respect to the LMP formula:

➢ Commissioner Moeller stated that he would have "preferred to allow [wholesale-market operators] to continue to develop their own rules." Pet. App. 157a-

159a. As discussed, the Commission explained that the regional differences identified in the comments had no bearing on the value that demand-response resources compensated at LMP bring to a wholesale-electricity market (when the net-benefits test is met). See *id.* at 104a, 224a-227a.

➢ Commissioner Moeller briefly asserted that the net-benefits test "unduly discriminates against demand resources" by requiring them to "show that [their] participation will depress the market price." Pet. App. 159a-161a. The Commission explained in detail why, because of the billing-unit effect, "a net benefits test is appropriate and workable" and that it is "reasonable to differentiate between demand response and generation as to this issue since only demand response produces the billing unit effect." *Id.* at 234a-239a; see *id.* at 92a-95a.

➢ Echoing the principal objection by commenters advocating LMP-G, Commissioner Moeller maintained that "the decision to pay demand resources the full LMP * * * results in overcompensation that is economically inefficient, preferential to demand resources, and unduly discriminatory towards other market resources." Pet. App. 161a-166a, 273a-274a. As discussed above (pp. 47-56, *supra*), the Commission extensively explained why LMP would not result in overcompensation, and that judgment was reasonable.

➢ Commissioner Moeller took issue with the Commission's statement that the LMP-G formula would produce administrative difficulties, noting that state commissions were divided on that question. Pet. App. 166a-168a. The Commission acknowledged that LMP-G was "perhaps feasible," but found that it

would "create practical difficulties for a number of parties, including state commissions and [wholesale-market operators]." *Id.* at 102a. In any event, the Commission clarified in the order on rehearing that its "determination in the Final Rule did not rest primarily on the imposition of [an administrative] burden" by the LMP-G formula. *Id.* at 223a.

➢ Commissioner Moeller, though acknowledging that "additional demand response participation will have the effect of lowering the market price," predicted that it would produce the "unintended effects" of discouraging long-term investment in generation. Pet. App. 168a-170a. The Commission rejected that argument for much the same reason that it found LMP to be an appropriate compensation formula: that "generation resources will not be subject to unfavorable treatment relative to demand response resources, because both types of resources will receive compensation at the LMP when the conditions of capability and cost-effectiveness are met." *Id.* at 221a. The Commission added that the argument "ignores the fact that demand resources increase competition among supply-side resources." *Ibid.*; see *id.* at 221a-222a.

There is thus no merit to the court of appeals' holding that FERC failed to meaningfully respond to objections to the LMP formula. It is true that FERC's orders did not directly cite Commissioner Moeller's dissenting statements. But that is not a mark of arbitrary decisionmaking.[9] Rather, "[t]he failure to re-

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[9] *E.g.*, *Zivotofsky* v. *Clinton*, 132 S. Ct. 1421 (2012); *Kansas* v. *Ventris*, 556 U.S. 586 (2009); *Commil USA, LLC* v. *Cisco Sys., Inc.*, 135 S. Ct. 1920 (2015); *Navarette* v. *California*, 134 S. Ct.

spond to [objections] is significant only insofar as it demonstrates that the agency's decision was not based on a consideration of the relevant factors." *Sherley* v. *Sebelius*, 689 F.3d 776, 784 (D.C. Cir. 2012), cert. denied, 133 S. Ct. 847 (2013). Here, FERC directly addressed the same policy objections that were raised by Commissioner Moeller and reached a different conclusion on the extraordinarily technical issue addressed in the Rule. That exercise of the agency's expert judgment is entitled to judicial deference. The court of appeals ruling to the contrary should be reversed.[10]

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1683 (2014); *NRG Power Marketing*, *supra*; *Kingsley* v. *Hendrickson*, No. 14-6368 (June 22, 2015); *Kentucky* v. *King*, 131 S. Ct. 1849 (2011); *Pepper* v. *United States*, 562 U.S. 476 (2011); *Mata* v. *Lynch*, No. 14-185 (June 15, 2015).

[10] Respondents California ISO and California Public Utilities Commission raised challenges to the Rule's cost-allocation principles that the court of appeals did not reach. If this Court reverses the decision below, the court of appeals should consider those arguments in the first instance on remand.

## CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded.

Respectfully submitted.

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JULY 2015

## APPENDIX

1. 16 U.S.C. 824 provides in pertinent part:

**Declaration of policy; application of subchapter**

**(a) Federal regulation of transmission and sale of electric energy**

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

**(b) Use or sale of electric energy in interstate commerce**

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchap-

ter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

(2) Notwithstanding subsection (f) of this section, the provisions of sections 824b(a)(2), 824e(e), 824i, 824j, 824j-1, 824k, 824*o*, 824p, 824q, 824r, 824s, 824t, 824u, and 824v of this title shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this chapter with respect to such provisions. Compliance with any order or rule of the Commission under the provisions of section 824b(a)(2), 824e(e), 824i, 824j, 824j-1, 824k, 824*o*, 824p, 824q, 824r, 824s, 824t, 824u, or 824v of this title, shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

**(c) Electric energy in interstate commerce**

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

**(d) "Sale of electric energy at wholesale" defined**

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

* * * * *

2. 16 U.S.C. 824d provides in pertinent part:

**Rates and charges; schedules; suspension of new rates; automatic adjustment clauses**

**(a) Just and reasonable rates**

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

**(b) Preference or advantage unlawful**

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

**(c) Schedules**

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

**(d) Notice required for rate changes**

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

**(e) Suspension of new rates; hearings; five-month period**

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require

such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

* * * * *

3. 16 U.S.C. 824e provides in pertinent part:

**Power of Commission to fix rates and charges; determination of cost of production or transmission**

**(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues**

Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed

and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

* * * * *

4. Section 1252 of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 965-966 provides in pertinent part:

**SEC. 1252. SMART METERING.**

* * * * *

(e) DEMAND RESPONSE AND REGIONAL COORDINATION.—

(1) IN GENERAL.—It is the policy of the United States to encourage States to coordinate, on a regional basis, State energy policies to provide reliable and affordable demand response services to the public.

(2) TECHNICAL ASSISTANCE.—The Secretary shall provide technical assistance to States and regional organizations formed by two or more States to assist them in—

(A) identifying the areas with the greatest demand response potential;

(B) identifying and resolving problems in transmission and distribution networks, including through the use of demand response;

(C) developing plans and programs to use demand response to respond to peak demand or emergency needs; and

(D) identifying specific measures consumers can take to participate in these demand response programs.

(3) REPORT.—Not later than 1 year after the date of enactment of the Energy Policy Act of 2005, the Commission shall prepare and publish an annual report, by appropriate region, that assesses demand response resources, including those available from all consumer classes, and which identifies and reviews—

(A) saturation and penetration rate of advanced meters and communications technologies, devices and systems;

(B) existing demand response programs and time-based rate programs;

(C) the annual resource contribution of demand resources;

(D) the potential for demand response as a quantifiable, reliable resource for regional planning purposes;

(E) steps taken to ensure that, in regional transmission planning and operations, demand resources are provided equitable treatment as a quantifiable, reliable resource relative to the resource obligations of any load-serving entity, transmission provider, or transmitting party; and

(F) regulatory barriers to improve customer participation in demand response, peak reduction and critical period pricing programs.

(f) FEDERAL ENCOURAGEMENT OF DEMAND RESPONSE DEVICES.—It is the policy of the United States that time-based pricing and other forms of demand response, whereby electricity customers are provided with electricity price signals and the ability to benefit by responding to them, shall be encouraged, the deployment of such technology and devices that enable electricity customers to participate in such pricing and demand response systems shall be facilitated, and unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated. It is further the policy of the United States that the benefits of such demand response that accrue to those not deploying such technology and devices, but who are part of the same regional electricity entity, shall be recognized.

* * * * *

5. Section 529 of the Energy Independence and Security Act of 2007, Pub. L. No. 110-140, 121 Stat. 1664-1665 provides in pertinent part:

* * * * *

SEC. 529. ELECTRICITY SECTOR DEMAND RESPONSE.

(a) IN GENERAL.—Title V of the National Energy Conservation Policy Act (42 U.S.C. 8241 et seq.) is amended by adding at the end the following:

"PART 5—PEAK DEMAND REDUCTION

"SEC. 571. NATIONAL ACTION PLAN FOR DEMAND RESPONSE.

"(a) NATIONAL ASSESSMENT AND REPORT.—The Federal Energy Regulatory Commission ('Commission') shall conduct a National Assessment of Demand Response. The Commission shall, within 18 months of the date of enactment of this part, submit a report to Congress that includes each of the following:

"(1) Estimation of nationwide demand response potential in 5 and 10 year horizons, including data on a State-by-State basis, and a methodology for updates of such estimates on an annual basis.

"(2) Estimation of how much of this potential can be achieved within 5 and 10 years after the enactment of this part accompanied by specific policy recommendations that if implemented can achieve the estimated potential. Such recommendations shall include options for funding and/or incentives for the development of demand response resources.

"(3) The Commission shall further note any barriers to demand response programs offering flexible, non-discriminatory, and fairly compensatory terms for the services and benefits made available, and shall provide recommendations for overcoming such barriers.

"(4) The Commission shall seek to take advantage of preexisting research and ongoing work, and shall insure that there is no duplication of effort.

"(b) NATIONAL ACTION PLAN ON DEMAND RESPONSE.—The Commission shall further develop a National Action Plan on Demand Response, soliciting and accepting input and participation from a broad range of industry stakeholders, State regulatory utility commissioners, and non-governmental groups. The Commission shall seek consensus where possible, and decide on optimum solutions to issues that defy consensus. Such Plan shall be completed within 1 year after the completion of the National Assessment of Demand Response, and shall meet each of the following objectives:

"(1) Identification of requirements for technical assistance to States to allow them to maximize the amount of demand response resources that can be developed and deployed.

"(2) Design and identification of requirements for implementation of a national communications program that includes broad-based customer education and support.

"(3) Development or identification of analytical tools, information, model regulatory provisions, model contracts, and other support materials for use by customers, States, utilities and demand response providers.

"(c) Upon completion, the National Action Plan on Demand Response shall be published, together with any favorable and dissenting comments submitted by participants in its preparation. Six months after publication, the Commission, together with the Secretary of Energy, shall submit to Congress a proposal to implement the Action Plan, including specific proposed assignments of responsibility, proposed budget amounts, and any agreements secured for participation from State and other participants.

"(d) AUTHORIZATION.—There are authorized to be appropriated to the Commission to carry out this section not more than $10,000,000 for each of the fiscal years 2008, 2009, and 2010."

* * * * *

6. 18 C.F.R. 35.28 provides in pertinent part:

**Non-discriminatory open access transmission tariff.**

* * * * *

(g) *Tariffs and operations of Commission-approved independent system operators and regional transmission organizations.*

(1) *Demand response and pricing.*

(i) *Ancillary services provided by demand response resources.*

(A) Every Commission-approved independent system operator or regional transmission organization that operates organized markets based on competitive bidding for energy imbalance, spinning reserves, supplemental reserves, reactive power and voltage control, or regulation and frequency response ancillary services (or its functional equivalent in the Commission-approved independent system operator's or regional transmission organization's tariff) must accept bids from demand response resources in these markets for that product on a basis comparable to any other resources, if the demand response resource meets the necessary technical requirements under the tariff, and submits a bid under the Commission-approved independent system operator's or regional transmission organization's bidding rules at or below the market-clearing price, unless not permitted by the laws or regulations of the relevant electric retail regulatory authority.

(B) Each Commission-approved independent system operator or regional transmission organization must allow providers of a demand response resource to specify the following in their bids:

(*1*) A maximum duration in hours that the demand response resource may be dispatched;

(*2*) A maximum number of times that the demand response resource may be dispatched during a day; and

(*3*) A maximum amount of electric energy reduction that the demand response resource may be required to provide either daily or weekly.

(ii) *Removal of deviation charges.* A Commission-approved independent system operator or regional transmission organization with a tariff that contains a day-ahead and a real-time market may not assess charge to a purchaser of electric energy in its day-ahead market for purchasing less power in the real-time market during a real-time market period for which the Commission-approved independent system operator or regional transmission organization declares an operating reserve shortage or makes a generic request to reduce load to avoid an operating reserve shortage.

(iii) *Aggregation of retail customers.* Each Commission-approved independent system operator and regional transmission organization must accept bids from an aggregator of retail customers that aggregates the demand response of the customers of utilities that distributed more than 4 million megawatt-hours in the previous fiscal year, and the customers of utilities that distributed 4 million megawatt-hours or less in the previous fiscal year, where the relevant electric retail regulatory authority permits such customers' demand response to be bid into organized markets by an aggregator of retail customers. An independent system operator or regional transmission organization must not accept bids from an aggregator of retail customers that aggregates the demand response of the customers of utilities that distributed more than 4 million megawatt-hours in the previous

fiscal year, where the relevant electric retail regulatory authority prohibits such customers' demand response to be bid into organized markets by an aggregator of retail customers, or the customers of utilities that distributed 4 million megawatt-hours or less in the previous fiscal year, unless the relevant electric retail regulatory authority permits such customers' demand response to be bid into organized markets by an aggregator of retail customers.

(iv) *Price formation during periods of operating reserve shortage.*

(A) Each Commission-approved independent system operator or regional transmission organization must modify its market rules to allow the market-clearing price during periods of operating reserve shortage to reach a level that rebalances supply and demand so as to maintain reliability while providing sufficient provisions for mitigating market power.

(B) A Commission-approved independent system operator or regional transmission organization may phase in this modification of its market rules.

(v) *Demand response compensation in energy markets.* Each Commission-approved independent system operator or regional transmission organization that has a tariff provision permitting demand response resources to participate as a resource in the energy market by reducing consumption of electric energy from their expected levels in response to price signals must:

(A) Pay to those demand response resources the market price for energy for these reductions when these demand response resources have the capability to balance supply and demand and when payment of the market price for energy to these resources is cost-effective as determined by a net benefits test accepted by the Commission;

(B) Allocate the costs associated with demand response compensation proportionally to all entities that purchase from the relevant energy market in the area(s) where the demand response reduces the market price for energy at the time when the demand response resource is committed or dispatched.

* * * * *